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Comment & Analysis: Fightback at the seat of power: Microsoft's chairman is making up for lost time as competitors establish their places in the Internet market, say Louise Kehoe and Hugo Dixon
By HUGO DIXON and LOUISE KEHOE

If you sit still, the value of what you have drops to zero pretty quickly.' Bill Gates is not sitting still, literally or figuratively. The Microsoft chairman and chief executive rocks vigorously back and forth as he fields questions about his company's response to competition from Internet software developers.

The rapid to-and-fro motion, a well-known Gates mannerism, seems particularly apposite. He was caught napping, critics charge, by the rapid advance of the Internet and how it would transform the personal computer software business.

Prophets of doom have predicted that the Internet could be Microsoft's undoing. Some have drawn parallels with International Business Machines, which found its domination of the computer industry undermined in the 1980s by low-cost microprocessor chips and software standards which left behind its mainframe technologies.

Now, as the world leader in personal computer software, Microsoft is being forced to adapt to the emergence of the Internet which is bringing new standards for how computers communicate. If he does not keep pace with his rivals, Microsoft PC software could be eclipsed.

Yet unlike IBM, whose sclerotic culture prevented it from adapting to change, Mr Gates is now moving rapidly to make up for lost time. Indeed, he is preparing to unveil the latest stage in his Internet counter-attack - his plans for corporate 'intranets', office networks that adhere to Internet standards - at a day-long presentation to customers, analysts and the media in California's Silicon Valley - this week.



His notoriously competitive spirit, which helped Microsoft achieve its dominant role for PC operating systems and applications, is now trained on his Internet rivals. The fact is that most of our operating systems competitors seem fatigued. Fine, now we have got new competitors,' he says. 'It is always fun to be the underdog.'

The motto for the fightback is 'embrace and extend'. In practical terms, this means putting the Internet at the centre of everything Microsoft does, he says. 'The Internet is not a fad in any way. It is a fantastic thing; it makes software and computers more relevant.'

His strategy is quickly to adapt Microsoft's core products so that they can use the existing capabilities of the Internet while creating new types of Internet programs ahead of his competitors.

Microsoft, however, is coming from behind. The company that virtually owns the playing field for the PC software market is being forced to play on its competitors' turf for the first time in many years. Without the 'home-field' advantage of control over standards to which it is accustomed, Microsoft's technical prowess will be put to the test.

The challenge comes from three main sources. The first is Sun Microsystems, the leading manufacturer of servers, the computers that store information distributed through the Internet and intranets. Sun has created Java, a programming language that is catching on fast among application software developers. On the back of Java's success, Sun has recently launched a range of related products that together constitute a new computing 'platform' to compete with PCs running Microsoft programs.

Then there is Netscape Communications, which leads the market for 'browser' programs that enable PC users to view multimedia documents on the Internet. The threat is that Netscape could displace Microsoft's Windows operating system.

The third Microsoft challenger is Oracle, the world leader in database software. It is trying to dethrone the PC from its dominance of desktop computing by promoting a new category of devices dubbed 'network computers' - low-cost terminals tailored to the Internet.

Mr Gates has answers to all three. To Sun, where Mr Scott McNealy, the chief executive, has been needling Mr Gates with a flurry of barbed witticisms, his riposte is: 'We don't compete with Sun, except in so far as McNealy can drive the laughmeter higher than anyone else.' Mr Gates is equally dismissive about Java: 'There are many computer languages. No one makes money creating languages.'

But what about the risk that tiny software applications, written in Java, could be distributed free over the Internet, undercutting Microsoft's applications business? Or the fact that Mr McNealy is attempting to capitalise on enthusiasm for Java by launching a range of related products including an operating system that could drive a wedge into Microsoft's markets.

Mr Gates claims to be unimpressed: 'We have always competed with free software. Just because the Internet is out there, it does not mean that people will throw away their applications,' he says. Neither is the Java operating system any threat to Windows, he maintains.

Mr Gates' response to Netscape's browser is less derisive. He is, at least, prepared to acknowledge the challenge: 'They are taking a browser and growing it into an operating system,' he says.

Mr Gates is perhaps willing to acknowledge this challenge because he has a clear strategy for countering it. By taking the good ideas from a browser and incorporating them in a new version of Windows, Mr Gates aims to present computer users with a 'single interface' - software that will enable them to find files stored on a PC's internal hard disk or on a remote Internet/ intranet server.

From Microsoft's perspective, browser software is no more than Windows dressing. With a browser built into Windows, PC users will have less incentive to purchase Netscape's software, Mr Gates believes. Of Netscape's lead in the browser market, he says simply: 'We will make it moot.'

However, Microsoft is not relying on technology alone in the battle of the browsers - not least because Netscape gained vast amounts of free publicity following its stunning stockmarket flotation last year. 'Netscape has got a lot of mindshare,' says Mr Gates. 'If they wanted to do a T-shirt, people would pay attention.'

Microsoft's counter-attack has been vicious. Not only is it giving away its competing browser over the Internet; it has recently signed deals with America Online and CompuServe, the two largest online information service companies, to adopt the Microsoft browser in exchange for promoting their services on future versions of Windows. He is also giving away software for Internet servers to anybody who buys the Windows NT operating system for business users. Netscape, which receives most of its revenues from selling server software, has had to slash prices on its basic server programs in response.

'Our business model works even if all Internet software is free,' says Mr Gates. 'We are still selling operating systems. What does Netscape's business model look like (if that happens)? Not very good.'

So much for Netscape. But what about the notion that network computers will usurp the role of the PC on office desktops and in the living rooms of consumers?

Although the network computer has yet to be tested in the market, it has struck a chord, particularly among those who buy computers for large companies. The attraction is not so much the cheap hardware, but the promise that network computers will be easier to maintain and support, cutting the cost of ownership of desktop computers.

In an office network environment, PCs can cost more than Dollars 10,000 a year, according to several industry studies. This includes the costs of user support, software and hardware upgrades, maintenance and other factors as well as the purchase price. If network computers take off, they could pose another threat to Microsoft because they would probably deploy software developed by Microsoft's rivals.

Mr Gates argues that, with Windows 95, there has been a 'huge advance' in reducing the total cost of owning a PC because both hardware and software upgrades have been simplified. Moreover, Internet communications will enable further improvements, he says, because it will be possible to provide advice and help to PC users online.

That said, he is scathing of those who want to cut the hassle of owning computers by curbing their range of functions. 'If you keep taking away things, you eventually get back to paper and pencil, which have a known cost of support. You have to teach users the language and grammar and so on. Other than that it is pretty straightforward.'

Network computer supporters would prevent users adding new gadgets to their computers, Mr Gates charges. 'What if you want a scanner or a video camera?' he asks, warming to his theme. 'The model proposed (for network computers) is 'forget about it'.

'Do people want less computing? No, people are getting more and more ambitious in what they do with their PCs. They want a lot more computing power.'

Now Mr Gates, who has often seemed on the defensive while facing Internet software competitors, is back in his more familiar role as the industry visionary. In future, he says, PCs will be used in different

ways. 'Take video-conferencing (on PCs). The amount of money the world is going to save through these new communications tools is absolutely mind-blowing.'

Speech recognition technology, under development at Microsoft and elsewhere, will enable people will talk to their PCs. Advances in multimedia technologies will allow PCs to display complex three-dimensional graphics on Internet pages that are individually tailored to a user's interests and needs, he predicts. All this will require more computer power and no doubt more Microsoft programs.

But what about all those people who do not have computers because they are too complex or expensive? Even in the US, fewer than 40 per cent of homes have PCs. 'You are right, it is embarrassing. We are only managing to sell 70m PCs a year. That is the headline']

In other words, the PC business going from strength the strength, and Mr Gates is seated firmly at the wheel.

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